

**October 1, 2009**

**RE: Current Events Memorandum  
2009 Estate Tax Exclusion**

President Obama has quickly begun to address the economy, the budget deficit, healthcare, taxes, and many other challenging issues, among them the uncertainty in the federal estate tax law.

For 2009, the estate tax exclusion amount is at a historic high of \$3.5 million, up from \$2 million in 2008, with a flat tax of 45% on the excess. As part of the tax reductions passed in 2001, however, the estate tax has been slated for a single year of full repeal in 2010. Further, the 2001 law was scheduled to expire in 2011 and return the estate tax with a top marginal rate of 55% and an applicable exclusion amount of only \$1 million. Most practitioners consider a full repeal followed by a return at higher rates to be unlikely, but no change in the 2001 law has yet been made.

On April 29, 2009, Congress agreed to a Budget Resolution “extending the law as in effect for 2009 for the Estate and Gift Tax” through 2019. The Budget Resolution does not specify the exact revisions to be made to the tax code, but at least it indicates the general direction the law will follow. More detailed guidance from Washington can be expected before long.

If this Resolution is enacted into law, it will give much needed certainty to the estate planning process. It will be a good time to review estate plans in light of the increased and stable federal exclusion amount. Other factors, such as historically low interest rates and reduced asset values, may also suggest changes, of course.

**Review of Existing Wills**

The increase of the federal estate exclusion to \$3.5 million (or \$7 Million for a couple, with appropriate planning), together with reduced asset values, may allow some clients to simplify their planning. However, many states have not raised their exclusion amounts to match the federal level. These lower and differing exclusions can have significant consequences.

**Credit Shelter Trusts.** Many Wills provide for “credit shelter trusts,” typically created to maximize the amount of assets passing free of estate tax on the surviving spouse’s death by taking advantage of the maximum federal exclusion. The increased federal exclusion amount may result in a Will creating a trust of up to \$3.5 million upon the death of the first spouse to die. Although a trust of this size is advantageous for federal tax purposes and will not trigger a federal estate tax, it may trigger significant state estate taxes due to lower state exclusions. For many clients, this result will be an unwelcome departure from a plan originally designed to defer all estate taxes until the second spouse’s death. Additionally, clients with such Wills may find that the size of the credit shelter trust substantially exceeds the amount originally anticipated, which could affect the surviving spouse’s access to resources.

Under these circumstances, formulae for smaller credit shelter trusts, designed to create trusts which will pass free of both federal and state estate taxes, may be worthy of consideration.

**Specific and “Cash” Bequests.** The proportion of an estate represented by bequests made to family members, other persons or charitable organizations, if in the form of stated dollar amounts or of specific property, may have been altered by declining asset values. Whether such bequests continue to meet a client’s original objectives relative to the overall value of his or her estate should be re-considered.

### **Estate Planning Techniques**

With an economic climate of declining asset valuations, reduced retirement savings, financial institutions facing difficulties and recession (or worse) dominating the news, lifetime transfers of assets to younger generations may seem to have a low priority. However, lower asset values combined with historically low interest rates present particularly attractive opportunities for transferring wealth.

**Grantor Retained Annuity Trust (“GRAT”).** This estate planning technique utilizes IRS-approved discount factors to make gifts of assets having the potential for appreciation with minimal or no gift tax consequences. In a GRAT, the client transfers property to an irrevocable trust, retaining the right to a fixed annuity for a term of years, and the value of the gift to the trust for gift tax purposes is reduced by the IRS-determined present value of the client’s retained interest. If the client survives the term of the trust, any property remaining in the trust, including any appreciation in the trust assets that exceeds the IRS-assumed rate of interest (which is 3.4% for September, 2009, and is recalculated monthly), passes to the client’s beneficiaries free of any gift or estate tax.

Obviously while some GRATs may appreciate and succeed, others may fail. A GRAT may currently be structured so as to “zero out” the taxable gift with an annuity set at a level so that the present value of the client’s retained interest is equal to the value of the property transferred to the trust. This approach allows the use of any number of GRATs, some of which are likely to succeed. There is some discussion that Congress

may change the law to require that a gift to a GRAT have a value of greater than zero for gift tax purposes, therefore requiring the use of a portion of the client's lifetime exclusion for gifts (currently at \$1 million, beyond which gift tax would be payable) and discouraging the use of an unlimited number of GRATs. However, low interest rates, currently low asset values and favorable law make a GRAT a particularly attractive estate planning tool at this time.

**Qualified Personal Residence Trust ("QPRT").** A silver lining of the cooling real estate market is the opportunity to use a QPRT to transfer a "personal residence" (e.g. your primary residence or your vacation home) to beneficiaries while values are low. In a QPRT, the client transfers a home to an irrevocable trust, retaining the right to reside in a home rent free for a fixed term of years. The amount of the taxable gift made upon the initial transfer of a home is the value of the residence, discounted by the IRS-determined present value of a client's retained interest. If the client survives the term of the trust, the value of the home, including all appreciation after the creation of the trust, will be removed from the client's taxable estate. After the trust term ends, a rental arrangement for the client's continued use of the home can be structured, and rent payments from the client to the beneficiaries (which can be used to pay property taxes, insurance and other home expenses) can further reduce the client's taxable estate. The trust can be extended and appropriate provisions included so that no income tax is payable by the beneficiaries on the rental income, thereby creating more tax savings.

**Low Interest Loans to Family Members.** Low interest loans can transfer significant value to family member without constituting gifts for tax purposes. The IRS prescribes minimum interest rates that must be charged to avoid triggering a taxable gift, but those rates are currently very low. Younger family members may be able to invest the borrowed funds for substantially higher returns. For example, in September, 2009, a client could lend a child (or other family member) an unlimited amount for a nearly nine-year term at the fixed rate of 2.87%. (If the loan term is nine years or longer, the minimum rate is currently 4.38%, and if the loan term is shorter than three years, the minimum rate is 0.84%.) The child's income and appreciation on the investment (net of the low interest payments) would belong to the child, free of gift or estate tax. This method is a particularly useful way to assist a child in purchasing a home at today's reduced prices.

**Non-Taxable Gifts.** The annual exclusion for gift tax purposes has been increased to \$13,000 per donee (or \$26,000 for married couples who are "gift-splitting"). Annual exclusion gifts remain among the most advantageous estate planning opportunities as they remove from the client's taxable estate not only the amounts of the gifts, but also any post-gift income and appreciation on the property. Such gifts could be utilized to transfer a family business or other interests that have declined in value. Gifts to pay tuition and medical expenses can be made in unlimited amounts if paid directly to the educational or medical institution. The special annual exclusion for gifts to non-citizen spouses has increased to \$133,000 for 2009, up from \$128,000.

**Life Insurance Trusts.** Life insurance continues to be a uniquely favored asset for estate tax purposes. If insurance on a client's life is acquired by a properly drafted and administered life insurance trust (or an existing policy is transferred to such a trust and the client survives another three years), it is possible for the insurance proceeds to be excluded from the client's taxable estate. A life insurance trust is especially useful for a client who is property rich and cash poor, as it can provide the family with a cash flow to pay for estate taxes and administration expenses. Clients considering the purchase of significant life insurance policies, or already having them in place, may wish to consider creating life insurance trusts.

**Family Limited Partnerships.** The IRS continues to attack the use of family limited partnerships and similar entities (such as limited liability companies) to transfer assets to family members at discounted values, but taxpayers have had some court victories in 2008. These cases are very fact-specified but have some common elements. To note a few, an entity is more likely to be respected for favorable tax treatment if: there were legitimate non-tax purposes for forming the entity; there is an ability to document active management of the entity's assets; the client refrains from the use of an entity as a "pocketbook" for personal expenses; and sufficient assets are maintained outside the entity to provide for the client's support and the payment of estate taxes on the client's death. Clients with family limited partnerships or similar entities in existence should ensure, in consultation with counsel and other advisors, that all necessary legal formalities (e.g., tax filings, periodic meetings, etc.) are being observed.

### **Retirement Plans**

**Required Minimum Distributions.** On December 23, 2008 President Bush signed the Worker, Retiree and Employer Recovery Act of 2008, which amends various statutes that govern pensions and other qualified retirement plans. Most notably, the Act suspends the application of the minimum distribution rules for 2009 as they apply to IRAs and "defined contribution plans" (such as 401(k) and profit sharing plans). With a few rare exceptions, owners of such accounts and the beneficiaries of deceased account owners will not be required to withdraw funds until 2010.

**Non-Spousal Rollovers.** It is now required that all qualified plans allow rollovers to IRAs not only for spouses who inherit such plans, but also for individual beneficiaries. Although not all of the benefits of spousal rollovers (such as the ability to designate subsequent beneficiaries over whose life expectancy distributions can be deferred) will be available, non-spousal rollovers increase the options for inherited retirement plans.

### **Powers of Attorney**

It is important to review any law changes affecting powers of attorney. These changes are especially relevant in the estate planning context, as they affect an agent's ability to assist the principal with estate planning transactions. Existing documents should be reviewed carefully to ensure that the provisions remain appropriate.

## **General Housekeeping**

As always, we recommend a review of your estate plan whenever there is a significant change in your family situation, your financial circumstance or the tax law. We also continue to recommend the periodic review of all of your estate planning documents, including your living wills, health care proxies, powers of attorney, and beneficiary designations for life insurance policies and retirement plans. Periodic reviews of life insurance coverage are also recommended in appropriate circumstances to assess whether existing coverage is adequate.

We hope you find this information helpful. If you have any questions about any of these concepts or developments discussed in this letter, we at **GLO CPAs LLLP** would be happy to review them with you.

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